No. 16-1454

In the Supreme Court of the United States

STATES OF OHIO, CONNECTICUT, IDAHO, ILLINOIS, IOWA, MARYLAND, MICHIGAN, MONTANA, RHODE ISLAND, UTAH, AND VERMONT,

Petitioners,

v.

AMERICAN EXPRESS COMPANY, AND AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONERS AND RESPONDENTS NEBRASKA, TENNESSEE, AND TEXAS

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QUESTION PRESENTED

This case asks how Section 1 of the Sherman Act, which bans unreasonable restraints of trade, applies to "two-sided" platforms that unite distinct customer groups. Such platforms are ubiquitous, ranging from eBay (serving buyers and sellers), to newspapers (serving readers and advertisers). Here, credit-card networks bring *cardholder* customers together with *merchant* customers for ordinary transactions. When doing so, Respondents American Express Company and American Express Travel Related Services Company ("Amex") contractually bar *merchant* customers from steering *cardholder* customers to credit cards that charge merchants lower prices. Applying the "rule of reason," the district court held that: (1) the Government proved that Amex's anti-steering provisions were anticompetitive because they stifled competition among credit-card companies for the prices charged to merchants, and (2) Amex failed to establish any procompetitive benefits. The Second Circuit reversed. It held that, to prove that the anti-steering provisions were anticompetitive (and so to transfer the burden of establishing procompetitive benefits to Amex), the Government bore the burden to show *not just* that the provisions had anticompetitive pricing effects on the merchant side, *but also* that those anticompetitive effects outweighed any benefits on the cardholder side. The question presented is:

Under the "rule of reason," did the Government's showing that Amex's anti-steering provisions stifled price competition on the merchant side of the credit-card platform suffice to prove anticompetitive effects and thereby shift to Amex the burden of establishing any procompetitive benefits from the provisions?

PARTIES TO THE PROCEEDINGS

The Petitioners in this Court and the Appellees in the Second Circuit are the States of Ohio, Connecticut, Idaho, Illinois, Iowa, Maryland, Michigan, Montana, Rhode Island, Utah, and Vermont.

The Appellees in the Second Circuit (and Respondents in this Court) also included the United States, and the States of Arizona, Missouri, Nebraska, New Hampshire, Tennessee, and Texas.

The Respondents in this Court and the Appellants in the Second Circuit are American Express Company and American Express Travel Related Services Company, Inc.

In the district court, the State of Hawaii was also originally a plaintiff, and MasterCard International, Inc. and Visa Inc. were also originally defendants.

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JURISDICTION

The Second Circuit entered its judgment on September 26, 2016, and denied en banc review on January 5, 2017. Petitioners received extensions of time to file a petition for certiorari until June 2, 2017. They filed a timely petition on that date. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

Section 1 of the Sherman Act provides in relevant part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1.

STATEMENT OF THE CASE

A. Today, Four Companies Dominate The Concentrated Credit-Card Industry

1. Credit cards have evolved for over a century. In the early 1900s, Sears started issuing lines of credit and then store cards to customers for their purchases. David Evans & Richard Schmalensee, *Paying with Plastic* 53 (2d ed. 2005). Department stores and oil companies also began issuing charge cards at this time. *Id.*; Pet. App. 10a n.11.

In the 1950s, the modern industry began to form with cardholders able to use the same card at differ-

ent merchants. Pet. App. 10a. Diners Club, for example, began by enlisting New York restaurants to accept payment via cards issued to restaurant goers. *Id.* "Unlike store cards, Diners Club cards provided a broader medium of exchange—one that extended to at least all the merchants in the club." Evans & Schmalensee, *supra*, at 54. It reimbursed restaurants, but charged them a percentage of the bill. *Id.* It also charged cardholders an annual fee. *Id.*

American Express also introduced a competing card in the 1950s. Pet. App. 11a. It "set its cardholder fee higher than the [Diners] Club cardholder fee and thereby cultivate[d] a prestigious, upscale image of 'exclusiv[ity].'" *Id.* (citation omitted). Both cards "were mainly used for travel and entertainment" rather than for everyday purchases. Evans & Schmalensee, *supra*, at 61. By 1966, American Express had become the volume leader. Pet. App. 12a.

In the 1960s, competing business models emerged. *Id.* The networks that became Visa and MasterCard began "as banking cooperatives that collaborated on a card brand to pool the merchants that individual member banks of the cooperative had signed up on their respective cards." *Id.* Later, in 1985, Sears introduced the Discover Card. Sears gained a foothold by "market[ing] Discover's cards to its already significant population of private label cardholders." *Id.* at 154a & n.24.

2. Today, general purpose credit and charge cards—"credit cards"—are "a principal means by which consumers in the United States purchase goods and services from the nation's millions of merchants." *Id.* at 73a-74a. The industry is "highly con-

centrated" with "four dominant networks": Visa, MasterCard, Discover, and American Express Co. and American Express Travel Related Services Company ("Amex"). *Id.* at 74a, 154a. These four networks account for nearly all U.S. credit-card transactions: Visa (45% share in 2013, as measured by charge volume), Amex (26.4%), MasterCard (23.3%), and Discover (5.3%). *Id.* at 151a.

"Credit cards enable cardholders to make purchases at participating merchants" quickly and easily. *Id.* at 75a. When a cardholder uses the card, "a multitude of economic acts" kick into gear. *Id.* at 5a. The cardholder accesses a credit line. *Id.* The merchant "receives payment quickly—minus a fee." *Id.*

As these exchanges show, credit-card networks serve two consumers—merchants and cardholders. "By facilitating transactions" between those groups, the networks operate what is known as a "two-sided" platform. *Id.* at 77a. "In a two-sided platform, a single firm or collection of firms sells different products or services to two separate yet interrelated groups of customers who, in turn, rely on the platform to intermediate some type of interaction between them." *Id.* These platforms are common in old and new industries: Newspapers unite readers and advertisers; computer operating systems connect application developers and end users. *Id.* The platforms often have "indirect or cross-platform network effects" in that "the number of agents or the quantity of services bought on one side of a two-sided platform affects the value that an agent on the other side of the platform can realize." *Id.* at 79a. A card's value to cardholders, for example, depends on the number of merchants that accept it; its value to merchants likewise

depends on the number of cardholders who use it. *Id.* This phenomenon—a "'chicken and the egg problem'"—creates significant entry barriers. *Id.* at 79a, 154a (citation omitted).

Credit-card platforms must balance the relative prices that they charge the two consumer groups. *Id.* at 80a. Cardholder demand for card use is more price sensitive than merchant demand for card acceptance, so "a network may charge its cardholders a lower fee than it charges merchants." *Id.* at 9a. Indeed, cardholders may "pay a 'negative' price . . . in the form of rewards earned on a per transaction basis." *Id.* at 182a n.36. Such "rewards" may include items like cash back, airline miles, or gift cards. *Id.* at 89a. Merchants, by contrast, must pay "merchant discount fees" to accept credit cards. *Id.* at 83a. Those fees are "a percentage discount rate multiplied by the purchase price" of the transaction (e.g., 2% of a $100 purchase would be $2). *Id.* They are "among many merchants' highest" costs. *Id.* at 221a-22a.

3. The four credit-card companies have different structures. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 234-36 (2d Cir. 2003). Visa and MasterCard operate open-loop networks "that can involve as many as five distinct actors." Pet. App. 81a. On one side of their platforms, these networks do not themselves issue cards to cardholders. *Id.* at 81a-82a. Instead, "issuers"—mostly banks like Chase or Capital One—sell cards, credit, and rewards to cardholders, and set the terms (such as the interest rates). *Id.* About "20,000 entities compete" for these cardholders. *Visa*, 344 F.3d at 237. On the other side of their platforms, Visa and MasterCard do not interact with merchants. Pet. App. 82a. Instead, "acquirers"—

again, mostly banks—contract with merchants to accept Visa and MasterCard, and reimburse these merchants for credit-card transactions. *Id.*

For Visa and MasterCard, then, "[t]he network's most fundamental function is to establish protocols and procedures by which issuers and acquirers capture, authorize, and settle transactions; they also establish nearly all elements of the price charged to merchants (except for the fee charged by the acquirer/processor)." *Id.* That price consists of the interchange fee (to the issuer bank), the acquirer bank fee, and the credit-card network fee. *Id.* at 83a. Visa and MasterCard (and their issuers) also pursue a "lend-centric" business strategy because they rely "on the interest charged on revolving balances to generate more than half of their revenue." *Id.* at 87a.

Amex, by contrast, operates a vertically integrated "closed-loop" network. *Id.* at 83a. It "acts as the card issuer and merchant acquirer for the vast majority of transactions involving its cards." *Id.* at 83a-84a. It sets both merchant fees and cardholder benefits. *Id.* at 86a, 89a. Under its "spend-centric" model, it charges higher fees (and generates more revenue from them) than the other networks. *Id.* at 86a-89a. It justifies this price premium to merchants by highlighting its affluent cardholders "who generally spend more on an annual and per transaction basis than non-cardholders." *Id.* at 88a. Amex uses some of these fees to fund its cardholder rewards that "encourage cardholders to use their cards for purchases at Amex-accepting merchants." *Id.* at 89a.

The smallest competitor, Discover, has a "hybrid" business model. *Id.* at 86a. It operates its own net-

work and issues its own cards (like Amex), "but relies on third-party acquirers and processors to service the merchant side of the platform" (like Visa and MasterCard). *Id.* Also like Visa and MasterCard, it pursues a "lend-centric" strategy. *Id.* at 87a.

Amex and Discover thus compete for cardholders with the thousands of banks issuing Visa and MasterCard cards. *Id.* at 117a. And the four networks compete for merchant acceptance. *Id.* About "3.4 million merchants at 6.4 million different merchant locations" accept Amex. *Id.* at 184a. Visa, MasterCard, and Discover, by comparison, are accepted at about 3 million more locations. *Id.* at 184a-85a. The "vast majority" of the merchants that make up this coverage gap are "very small." *Id.* at 224a. One report, for example, found that 98 of the top 100 retailers accepted Amex, and that the other two did not accept credit cards. R.590, Stipulation, ¶ 12, PageID#30295.

B. Amex's Merchant Agreements Increase Prices By Barring Merchants From Steering Cardholders To Low-Cost Cards

1. In the late 1980s, Amex gained market share by expanding outside its travel-and-entertainment markets into "everyday spend" markets, like gas stations and grocery stores. Pet. App. 91a. Visa and MasterCard reacted to this expansion into their "bread and butter" territory with both competitive and exclusionary conduct. *Id.* As for the competitive conduct, they began advertising campaigns—like "We Prefer Visa"—that targeted Amex's higher merchant prices. *Id.* at 92a. This succeeded in shifting share because Amex "was, in fact, markedly more

expensive." *Id.* at 201a. As for the exclusionary conduct, Visa and MasterCard barred their issuing banks from issuing Amex or Discover cards. Pet. App. 91a. A district court held that this ban violated Section 1 of the Sherman Act, and the Second Circuit affirmed. *Visa*, 344 F.3d at 240-43.

In response to the preference campaigns, Amex bolstered "its contractual restraints on merchants." Pet. App. 200a. These restraints had existed "in one form or another since the 1950s." *Id.* at 93a. Yet Amex made them stricter and "intensified its efforts to enforce" them. *Id.* Its modern "anti-steering provisions" are the fruit of these efforts. J.A. 99 (standard agreement); J.A. 97-98 (merchant regulations). Under these provisions, merchants that accept Amex may not, among other things, (1) "indicate or imply" a preference for non-Amex cards; (2) "dissuade" customers from using Amex cards; (3) "persuade or prompt" other cards; (4) "impose any restrictions, conditions, disadvantages, or fees" on Amex cards "that are not imposed equally on" other cards; or (5) "promote" other cards (other than private-label cards) "more actively than [they] promote" Amex cards. J.A. 97-98. (Consistent with the Durbin Amendment in the Dodd-Frank law, these rules do not bar merchants from steering toward debit or cash. Pet. App. 20a n.38.)

"In practice," Amex's anti-steering provisions "block Amex-accepting merchants from encouraging their customers to use any credit or charge card other than an American Express card, even where that card is less expensive for the merchant to accept." *Id.* at 100a. A merchant may not, for example, incentivize a less expensive card by: offering a price dis-

count or other monetary incentive (like free shipping); offering a non-monetary incentive (like priority boarding or special check-out lanes); displaying accurate information about the relative costs of various cards; or "in any way signaling that the merchant's retail prices might be lower if it were better able to control its credit card costs." *Id.* at 100a-01a.

Amex's standard agreements bind most merchants to its anti-steering provisions. *Id.* at 94a-95a. While Amex does customize contracts for some merchants, its non-standard contracts also typically "restrict nearly all forms of point-of-sale steering." *Id.* at 97a. Amex "actively monitors" and "vigorously enforces" its anti-steering provisions. *Id.* at 102a-03a.

2. Anti-steering provisions prevent the credit-card market from functioning like a normal market, where "if you reduce your price, you should see increases in volume and gain market share." Tr. 832 (Hochschild/Discover). Once a merchant accepts a network, *cardholders* choose the card to use for a transaction; the anti-steering provisions bar *merchants* from influencing that choice. Pet. App. 195a. With cardholders unaware of merchant costs, the provisions "sever[] the typical link between merchants' demand for network services and the price charged for the same." *Id.* This stifles price competition. As an Amex executive conceded, "I don't think anybody's business strategy is to be cheaper than the next guy." Tr. 2668 (Funda/Amex). That is not for a lack of trying. Discover attempted to become the low-cost option, but its cost-cutting failed because the anti-steering provisions barred merchants from turning its lower prices into greater share. Pet. App.

203a-07a. The result: "higher all-in merchant prices" for *all four* networks. *Id.* at 207a.

Merchants recognize these higher prices. Retailers operating in competitive markets face relentless pressure to cut costs. Tr. 1343-44 (Rein/Walgreens). As a Southwest Airlines executive noted, "[i]f we don't drive our costs down, we can't set our prices; somebody else will do that for us." Tr. 2372 (Priebe/Southwest). To reduce the cost of inputs, a merchant might use a bidding process to gain preferential supplier contracts or leverage purchasing volume "to realize economies of scale." Tr. 381-82 (Robinson/Ikea). Or a merchant might try to reduce its input purchases. Alaska Airlines lowered its fuel consumption by replacing 30-pound flight manuals with iPads, and drilling holes in beverage-cart drawers to reduce weight. Tr. 222 (Thiel/Alaska Airlines).

When it comes to credit-card costs, however, merchants have little control. Pet. App. 198a. A Home Depot executive explained that "[t]here is very little that [it] can do" to prevent increases in those costs. Tr. 1223 (Kimmet/Home Depot). Ikea, too, does not "bid for credit card services," and finds itself "locked into a cost structure that doesn't change." Tr. 382 (Robinson/Ikea). Alaska Airlines does not strategize about how to deal with credit-card costs because it cannot "get the credit card networks to compete on the fees they charge." Tr. 224 (Thiel/Alaska Airlines). Similarly, Hilton was not rewarded with lower rates when it increased its Amex volume; it saw price hikes instead. Tr. 1609 (Brennan/Hilton).

Ultimately, merchants pass on higher credit-card costs to consumers through higher retail prices. Pet.

App. 210a-11a. As a former Walgreens executive noted, "we have to pass [credit-card] costs on to our customers. The customers eventually have to pay." Tr. 1406 (Rein/Walgreens). And because retailers usually charge the same prices no matter what payment a customer uses, customers paying with cheap credit cards subsidize the rewards of high-cost customers. Pet. App. 212a. Conversely, retailers would pass on much of the savings from credit-card competition to consumers, "typically in the form of a price decrease." Tr. 1278 (Kimmet/Home Depot). With steering, merchants could seek preference pricing and "look to return some of those savings to [their] customers." Tr. 2328-29 (Bruno/Crate & Barrel); Tr. 1543-44 (O'Malley/Best Buy).

C. The District Court Found That Amex's Anti-Steering Provisions Harmed Consumers In Violation Of Section 1

The United States and 17 States ("the Government") sued Visa, MasterCard, and Amex, alleging that their anti-steering provisions violated Section 1 of the Sherman Act by impeding *industrywide* competition over merchant prices. Pet. App. 21a-22a.

Before trial, Visa and MasterCard settled by voluntarily rescinding their anti-steering provisions. *Id.* at 22a. Those companies now may not bar merchants from offering discounts or nonmonetary benefits to customers for using particular cards. R.143, Final J., PageID#3338. The companies, however, may enforce rules prohibiting merchants from disparaging their brands. *Id.*, PageID#3340.

Amex went to trial. The court held a seven-week bench trial, which included over 1,000 exhibits, four

expert witnesses, and 34 fact witnesses. Pet. App. 72a. (A witness index is at J.A. 273-75.) The court concluded that the anti-steering provisions violated Section 1. *Id.* at 259a. It noted that Section 1 barred unreasonable restraints, and that the rule of reason typically applied to vertical agreements between entities at different market levels. *Id.* at 105a-06a. Yet the restraints here did "not fit neatly into the standard taxonomy" because, while vertical in nature, they restricted horizontal competition between networks. *Id.* at 106a-07a. The court nevertheless reviewed the restraints under the usual burden-shifting approach: The Government must prove anticompetitive effects, which shifts to Amex the duty to provide procompetitive rationales. *Id.* at 107a-10a.

1. *Relevant Market.* To determine the effects of Amex's restraints, the court defined the relevant market as "the market for general purpose credit and charge card network services" provided to *merchants*. *Id.* at 112a-13a. In doing so, the court rejected Amex's argument that the market should encompass *merchants* and *cardholders*. *Id.* at 116a-18a. It found that the different services provided to the different customers were "separate" products, but conceded "that these markets are inextricably linked." *Id.* at 118a. It also rejected Amex's argument that debit cards fell within the market. *Id.* at 122a-43a.

2. *Anticompetitive Effects.* For two reasons, the district court found that the anti-steering provisions were anticompetitive. *Id.* at 148a. To begin with, Amex had market power. *Id.* at 148a-91a. It accounted for 26.4% of a market with only four players. *Id.* at 151a. The market also contained high entry barriers. *Id.* at 153a-54a. And Amex's "loyal card-

holder base"—who "would shop elsewhere or spend less if unable to use" Amex—allowed it to increase merchant prices without much attrition. *Id.* at 156a-65a. Amex had, in fact, previously raised prices without losing many merchants. *Id.* at 165a-72a.

In addition, Amex's provisions harmed price competition. *Id.* at 191a-228a. They prevented merchants from reacting to price increases by steering cardholders to low-cost cards and shifting share to cost-cutting networks. *Id.* at 195a. And they made it "nearly impossible for a firm to enter the relevant market by offering merchants a low-cost alternative to the existing networks." *Id.* at 203a. The provisions thus enabled *all* four networks to charge higher prices. *Id.* at 210a. Merchants, in turn, passed much "of their additional costs along to their customers in the form of higher retail prices." *Id.* at 210a-11a. While Amex cardholders reaped some rewards in response, those benefits only partially offset the higher prices. *Id.* at 209a. Customers who used cash or cheaper cards subsidized Amex's "relatively small, affluent cardholder base." *Id.* at 212a.

3. *Procompetitive Rationales.* The district court rejected Amex's procompetitive rationales: that its anti-steering provisions preserved its business model, and prevented free-riding. *Id.* at 229a. The court found that the first argument—that Amex's "model could not survive" with competition—conflicted with the Sherman Act. *Id.* at 235a. Amex could not decide "on behalf of the entire market which legitimate forms of interbrand competition should be available and which should not." *Id.* at 240a.

The court also rejected Amex's arguments that its anti-steering provisions stopped "free-riding," i.e., using a benefit without paying for it. *Id.* at 250a-58a. While Amex gave merchants "analytics-based services," it could charge for those services separately. *Id.* at 252a-53a. Amex's rewards program also did not allow for free-riding. "[T]he network does not incur any cost [for rewards] if the cardholder is successfully steered away from" Amex. *Id.* at 256a.

4. *Remedy*. The court entered a permanent injunction. *Id.* at 294a-319a. Under that injunction, Amex could not bar merchants from, among other things, offering discounts for competing cards. Pet. App. 298a-300a. Yet it could prevent merchants from making misleading or disparaging statements about its brand. *Id.* at 302a-03a.

D. The Second Circuit Reversed, Holding That The Government Did Not Establish Any Anticompetitive Effects

The Second Circuit reversed the injunction, and directed a judgment for Amex. *Id.* at 4a. It did not disturb the district court's fact-findings. *Id.* at 24a-53a. Instead, it held that the district court committed three legal errors. *Id.* These perceived errors—all of which were tied to the district court's purported failure to consider the *cardholder* side of the credit-card platform—were said to show that the Government failed to prove anticompetitive harm. *Id.*

First, the Second Circuit held that the district court defined the market too narrowly. *Id.* at 31a-40a. Whereas the district court defined the market as services to *merchants*, the circuit court held that the market must include services to *cardholders*. *Id.*

at 32a. "Separating the two markets," the court said, "allows legitimate competitive activities" to be penalized. *Id.* at 35a. It justified this broad definition because a price increase on merchants might lead merchants to reject the network, which "might cause some cardholders to switch to alternative forms of payment." *Id.* at 39a. For credit-card networks, the panel found, courts "must consider the feedback effects inherent on the platform by accounting for the reduction in cardholders' demand for cards (or card transactions) that would accompany any degree of merchant attrition" from higher prices. *Id.*

Second, the Second Circuit rejected the district court's market-power holding. *Id.* at 40a-48a. The district court focused on Amex's ability to increase merchant prices, but "merchant pricing is only one half of the pertinent equation." *Id.* at 44a. A proper analysis, the circuit court held, required the Government to show that these price increases for merchants were not offset by price decreases for cardholders (in the form of benefits). *Id.* The Second Circuit also deemed the district court's market-power conclusion marred by its reliance on the "insistence" of Amex cardholders to use Amex. *Id.* at 45a-48a. It reasoned that cardholder satisfaction is what "makes it worthwhile for merchants to pay the relatively high fees that Amex charges." *Id.* at 45a-46a.

Third, the Second Circuit rejected the district court's holding that the anti-steering provisions caused actual anticompetitive effects in the form of higher merchant prices, again because it did not account for cardholder rewards. *Id.* at 49a-53a. In the Second Circuit's view, the Government needed to show that merchants *and* cardholders were "worse

off overall." *Id.* at 51a. And while the district court found that higher merchant prices caused higher retail prices for *all consumers*, the Second Circuit held that this finding did not account for the rewards enjoyed by *Amex cardholders*. *Id.* at 49a n.52. "Without evidence of the net price affecting consumers on both sides of the platform," the Second Circuit held, "the District Court could not have properly concluded that a reduction in the merchant-discount fee would benefit the two-sided platform overall." *Id.* at 53a.

SUMMARY OF ARGUMENT

I.A. This Court's cases applying Section 1 have balanced two concerns. To begin with, Section 1 is a "consumer welfare prescription." It assists consumers by protecting *interbrand competition* among firms selling similar products. That competition promotes allocative efficiency (and consumer welfare) because it reduces the prices of products to their marginal costs. It also achieves the best mix of products in terms of their price, quality, service, and the like.

In addition, Section 1's framework must develop in ways that lawyers and businesses can understand, and that judges and juries can apply. These administrative concerns have led the Court to tailor Section 1's rules to a restraint's likely effects. Restraints that will almost always harm consumers are *per se* illegal. And a case-by-case "rule of reason" applies to restraints with unclear effects.

B. These consumer-welfare ends and administrative concerns should also guide analysis *within* the rule of reason. As lower courts have held, that rule initially requires the Government to prove a restraint's anticompetitive effects—i.e., its consumer

harms. The level of proof required should turn on the restraint's potential adverse effects. Likely anticompetitive restraints invite a "quick look." Potentially procompetitive ones demand a more detailed market analysis. If the Government meets this burden, the defendant must then present a procompetitive rationale. For example, restraints may reduce competition in order to achieve productive efficiencies that lower costs. But competitors may not justify a restraint on the ground that it protects inefficient firms from "ruinous competition."

II. Here, the Government met its burden under the rule of reason when it proved that Amex's anti-steering provisions caused *industrywide* increases in merchant prices above levels that would exist if the four networks competed over those prices.

A. Amex's restraints implicate Section 1's primary purpose to protect *interbrand* competition. While Amex's merchant agreements are *vertical* in nature, they have *horizontal* effects because they limit competition among Amex, Visa, MasterCard, and Discover over merchant prices. These restraints thus differ from pure vertical restraints, like resale price maintenance, that limit only *intrabrand* competition. In addition, the credit-card industry is highly concentrated, with significant entry barriers. All of the competitors also used similar restraints before this litigation. That these interbrand restraints blanketed a concentrated industry enhances their risks.

B. Whatever standard of proof applies, the Government met its burden by providing *direct* evidence of the restraints' *actual* effects: higher prices.

Economic Theory. The anti-steering provisions have the potential for adverse effects because they make price unresponsive to demand. Once merchants accept Amex, Amex's restraints bar them from steering customers to low-cost cards. The cardholder *alone* chooses how to pay—without knowledge of the relative costs to merchants. With demand unresponsive to price, networks have no incentive to cut prices because price cuts will not generate higher market share.

History of Restraint. Amex designed its restraints to have these effects. In the 1990s, Amex strengthened its anti-steering provisions in response to its competitors' "preference" campaigns. By encouraging merchant steering, those campaigns were shifting market share to low-cost cards and putting downward pricing pressure on Amex. Amex's restraints allowed it to crush this price competition and halt that share shift without lowering price.

Real-World Effects. By restricting price competition, Amex's restraints have caused *all four* networks to increase their merchant prices. Those restraints facilitated Amex's "Value Recapture" initiatives (that is, its price increases). They also helped Visa and MasterCard increase their merchant fees and reduce the gap between their prices and Amex's traditional premium price. As for Discover, it initially saw an opportunity to become the low-price option given its competitors' price increases. But the anti-steering provisions blocked its price-cutting approach. So Discover changed strategies by charging prices closer to its competitors' higher levels.

III.A. The Second Circuit wrongly required the Government to prove that higher merchant prices were not "offset" by higher cardholder rewards. This mandate conflicts with: the Court's cases, consumer-welfare goals, administrative concerns, and the traditional market-definition test.

Precedent. This Court has held that competition sets the optimal mix of a product's "price" and "nonprice" attributes. Thus, competitors could not justify horizontal agreements raising engineering or dental prices on the ground that this price restriction "channeled" competition into the quality side of those markets. The Second Circuit wrongly held the opposite here, justifying a restraint over price competition on the ground that it "protect[ed]" the "revenue" that Amex used to compete over rewards. But *competition* should set the "optimal" mix of merchant prices and cardholder rewards.

Consumer Welfare. Basic economic theory shows that price restrictions (and higher prices) harm consumers, and that those harms will not be "offset" by other types of competition. A horizontal *price* cartel, for example, incentivizes cartelists to compete over *service*, but those services will not offset the higher prices. Instead, the cartel generates a misallocation of resources, with consumers receiving services that they do not value at their costs. That misallocation arises here. *Amex cardholders* do not value the rewards at their full cost because *all consumers* pay those costs through higher retail prices.

Administration. The Second Circuit's "offset" requirement increases administrative costs. Its inquiry requires "pass-on" calculations that this Court

has rejected in other areas. And the Court should be especially reluctant to place this burden on the Government because Amex seeks to defend a current anticompetitive harm (higher prices) with a conjectural procompetitive benefit (future rewards).

Relevant Market. The Second Circuit's novel market-definition test confirms its error. This Court has long held that two products fall within the same market if a consumer could reasonably switch to one product when the price of the other increased. Under that test, cardholder services and merchant services are not in the same market; merchants could not become cardholders if networks raised merchant prices. These products are complements, not substitutes.

B. In any event, the Government proved that Amex's anti-steering provisions harmed *all* consumers. The district court found that merchants pass on higher merchant prices to retail consumers through higher retail prices. And it found that Amex did *not* pass on to cardholders all of the revenue that it received from these higher prices. Thus, Amex's anti-steering provisions generated a higher "net" price.

ARGUMENT

I. THE RULE OF REASON SHOULD IMPLEMENT SECTION 1'S CONSUMER-WELFARE GOALS IN A WORKABLE WAY

Section 1 bars "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce." 15 U.S.C. § 1. The Court has never read this text literally, because "restraint is the very essence of every contract." *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679,

687-88 (1978). An "agreement" among a business's employees, for example, eliminates competition between them, but cooperation within corporations has never "raise[d] the antitrust dangers that § 1 was designed to police." *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984). Instead, the Court has long read Section 1 against the common-law backdrop to bar only *unreasonable* restraints. *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 59-60 (1911). To decide what is "unreasonable," the Court's tiers of antitrust scrutiny weigh consumer-welfare goals against administrative concerns. That same balance should guide analysis *within* the rule-of-reason tier.

A. The Court's Tiers Of Antitrust Scrutiny Balance Consumer-Welfare Goals Against Administrative Considerations

The judiciary's "evolution" concerning how to assess a restraint's reasonableness has "represent[ed] an effort carefully to blend" two factors: (1) "the pro-competitive objectives of the law of antitrust," and (2) "administrative necessity." *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 794 (1999) (Breyer, J., concurring in part and dissenting in part).

1. Section 1 protects the competition that promotes consumer welfare

To identify unreasonable restraints, courts must begin with "the point of the law." Robert Bork, *The Antitrust Paradox* 50 (1993). "Congress designed the Sherman Act as a 'consumer welfare prescription.'" *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (citation omitted). The Act protects consumers by protecting competition. "It rests on the premise that the

unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1957). Competition advances consumer welfare by promoting allocative efficiency and lowering prices for products to levels "approximating [their] marginal cost." *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 459 (1986).

Section 1's consumer-welfare focus bars courts from assessing a restraint's "reasonableness" in the abstract divorced from competitive conditions. Bork, *supra*, at 426-29. Even when, for example, lawyers refused to represent indigent criminal defendants in order to promote better legal representation, the antitrust laws did not consider that restraint's "social utility." *FTC v. Superior Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 421-22 (1990). A restraint's reasonableness also does not turn on the "process" that a party receives; "the absence of procedural safeguards can in no sense determine the antitrust analysis." *Nw. Wholesale Stationers v. Pac. Stationery & Printing*, 472 U.S. 284, 293 (1985). Nor is the Sherman Act a tort law. "Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws." *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225 (1993).

Instead of undertaking an amorphous reasonableness inquiry, courts must "focus[] directly on the challenged restraint's impact on competitive conditions." *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 688. A restraint is unreasonable only if *anticompetitive*, and reasonable if *procompetitive*. *Atl. Richfield Co. v.*

USA Petroleum Co., 495 U.S. 328, 342 (1990). And these terms have special meaning in this context; they distinguish restraints that are "harmful to the consumer" from restraints that are in the "consumer's best interest." *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007). An anticompetitive restraint "obstructs the achievement of competition's basic goals—lower prices, better products, and more efficient production methods." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, J.). A procompetitive restraint increases economic efficiencies in the production or distribution of a product and thereby reduces its cost or increases its quality. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979).

A comparison of naked horizontal restraints with purely vertical ones shows this consumer-welfare divide. The Court has viewed with skepticism naked *horizontal* restraints—i.e., restraints between firms at the same market level (like competing manufacturers) that seek only to restrict *interbrand* competition (competition among different brands of similar products). A cartel's "[r]estrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit." *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 107-08 (1984). Those restraints represent the "core case for antitrust regulation" because they generate an "externality" harming consumers. Douglas Ginsburg, *Rationalizing Antitrust*, 35 Antitrust Bull. 329, 331 (1990). Cartels impose social costs in the form of "a transfer of wealth from consumers to producers as well as a deadweight loss to society" from lost transactions that do not occur because of

higher prices. *Id.* Cartel members will also expend resources to obtain greater shares of the cartel's profits, and those "higher costs are a cost of" cartels too. Richard Posner, *Antitrust Law* 14 (2d ed. 2001). Thus, "the primary purpose of the antitrust laws is to protect interbrand competition" and prevent these consumer losses. *State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997).

The Court requires greater analysis for pure *vertical* restraints—i.e., restraints between firms at different market levels (such as a manufacturer and retailers) that seek only to limit *intrabrand* competition (competition among firms selling the same brand). These restraints—like an agreement between a manufacturer and a retailer about the price that the retailer may charge for the manufacturer's goods—can be anticompetitive if they facilitate a cartel. *Leegin*, 551 U.S. at 892-94. Yet a manufacturer may impose them to enhance the "'efficient distribution of [its] products.'" *Id.* at 901-02 (citation omitted). Resale price maintenance, for example, may fix a "free rider" problem. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 212-13 (D.C. Cir. 1986) (Bork, J.). Retailers who furnish services for a product may generate greater demand for it (but have to price it at a level that accounts for the services). If "discounting retailers" who do not furnish the services undercut the service providers, it could eliminate the services that the manufacturer seeks. *Leegin*, 551 U.S. at 890-91. Thus, *intrabrand* restraints may enhance *interbrand* competition by allowing consumers to "choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between." *Id.* at 890.

2. The Court has implemented the antitrust laws' consumer-welfare goals with institutional considerations in mind

To identify unreasonable restraints, courts must also confront administrative concerns. "[U]nlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients." *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.). That system should seek "to minimize the total costs of (1) anticompetitive practices that escape condemnation; (2) competitive practices that are condemned or deterred; and (3) the system itself." Frank Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 158 (1984). It should also seek to provide clear rules. *Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc.*, 555 U.S. 438, 452 (2009).

The Court's cases account for these concerns. Its test for predatory-pricing claims—claims that a producer has cut prices below cost to eradicate rivals and recoup monopoly profits later—provides a good example. There, the Court has noted, "the costs of an erroneous finding of liability are high" because "'[t]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition.'" *Brooke Grp.*, 509 U.S. at 226-27 (citation omitted). The Court thus opted for demanding liability rules. *Id.* Similarly, the Court has refused to allow a price-fixer to assert, as a defense to a damages action, that a plaintiff retailer merely passed on higher prices to its customers. *See Hanover Shoe, Inc. v. United Shoe*

Mach. Corp., 392 U.S. 481, 491-94 (1968). The Court believed that, even though "pass-on" occurs, it could be difficult to measure "in the real economic world rather than an economist's hypothetical model." *Id.* at 493; *Ill. Brick Co. v. Illinois*, 431 U.S. 720, 731-33 (1977); *cf. Pac. Bell.*, 555 U.S. at 453.

Similar administrative concerns drive the Court's two "methods" for answering Section 1's reasonableness question—the *per se* rule and the rule of reason. *NCAA*, 468 U.S. at 103 The Court treats some restraints—e.g., naked horizontal agreements to fix prices or divide markets—as *per se* illegal. *Leegin*, 551 U.S. at 886. The Court does so "'once experience with a particular kind of restraint enables the Court to predict with confidence that'" it would almost always be enjoined because of its "predictable and pernicious anticompetitive effect." *Khan*, 522 U.S. at 10 (citations omitted). These *per se* rules serve administrative goals. Even if a restraint covered by a *per se* rule might sometimes be procompetitive, that rule reduces costs by "provid[ing] guidance to the business community" and "minimiz[ing] the burdens on litigants and the judicial system." *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 n.16 (1977).

Where, by contrast, the "economic impact" of a restraint is "not immediately obvious," the administrative balance tips away from *per se* rules toward the more nuanced rule of reason. *Ind. Fed'n*, 476 U.S. at 459. In that setting, the risk that a *per se* rule would invalidate too much efficiency-enhancing conduct outweighs that bright-line rule's administrative savings. *Leegin*, 551 U.S. at 894-95. The rule of reason instead applies on a *restraint-by-restraint* basis to separate restraints that impede competition merely

to raise prices (and harm consumers) from restraints that increase productive or distributive efficiencies (and help consumers). *Id.* at 885-86.

B. These Consumer-Welfare And Institutional Concerns Should Guide The Rule Of Reason

Under the rule of reason, this Court has noted, "the factfinder weighs all of the circumstances," *GTE Sylvania*, 433 U.S. at 49, "including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect," *Khan*, 522 U.S. at 10. Yet a consider-everything approach "produces notoriously high litigation costs and unpredictable results." *Kimble v. Marvel Entm't, LLC*, 135 S. Ct. 2401, 2411 (2015); Herbert Hovenkamp, *The Antitrust Enterprise* 105 (2005); Easterbrook, *supra*, at 154-57. The Court thus should structure the rule in a way that "avoid[s], on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question—that of the presence of significant unjustified anticompetitive consequences." *FTC v. Actavis, Inc.*, 133 S. Ct. 2223, 2238 (2013).

Courts have long attempted to achieve this balance through a burden-shifting approach: (1) a plaintiff must prove that a restraint has anticompetitive effects harmful to consumers; (2) the defendant may then provide the restraint's procompetitive, efficiency rationale; and (3) the plaintiff can retort that any asserted efficiencies could be achieved through less an-

ticompetitive means. 7 Phillip Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1502, at 390 (3d ed. 2010); Michael Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 BYU L. Rev. 1265, 1268-69; *e.g.*, *United States v. Brown Univ.*, 5 F.3d 658, 668-69 (3d Cir. 1993). This approach establishes a general rule-of-reason framework, while leaving flexibility for individual adjustments.

1. *Government's Burden.* The Government must prove that a restraint injures consumers. That is, the restraint must restrict competition in a way that undermines competition's purpose to advance allocative efficiency by reducing prices to levels approaching marginal costs. *Ind. Fed'n*, 476 U.S. at 459.

"'[T]he quality of proof required'" to meet this burden "'should vary with the circumstances.'" *Actavis*, 133 S. Ct. at 2238 (citation omitted). As the first step in any rule-of-reason case, therefore, courts must assess the restraint's "potential for genuine adverse effects on competition." *Ind. Fed'n*, 476 U.S. at 460. Identifying these harms allows courts "to make a preliminary judgment about the inferences that can be drawn from everyday experience or economic theory with respect to the probability that any such evil will occur, its likely magnitude, and what evidence might be probative." 7 Areeda & Hovenkamp, *supra*, ¶ 1503, at 390-91. If a court concludes that anticompetitive harms are likely, it should require less demanding proof. And vice versa.

On one end of this spectrum, a "'quick-look' analysis" applies if "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompet-

itive effect on customers and markets." *Cal. Dental Ass'n*, 526 U.S. at 770. Given the likely consumer harms, this truncated analysis eliminates the Government's burden to show *actual* effects before requiring defendants to offer efficiency rationales. *NCAA*, 468 U.S. at 109-10 & n.42. This doctrine often applies to "horizontal restraint[s]" that fall outside the *per se* rule, but that restrict *interbrand* competition among competitors. *Id.* at 99; *e.g.*, *Cal. Dental Ass'n*, 526 U.S. at 769-70.

On the other end, an "inquiry into market power and market structure" governs restraints with unclear effects. *Copperweld*, 467 U.S. at 768. Under the most demanding requirements, the Government must establish that a restraint will have, or has had, negative effects on allocative efficiency and consumer welfare—e.g., that it will raise market prices above those that would exist with competition. *NCAA*, 468 U.S. at 109 n.38 (defining "market power"). The Government may meet this burden through direct or indirect methods. *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir. 1995). Under the direct method, the Government may prove that the restraint has had "'actual detrimental effects, such as a reduction of output.'" *Ind. Fed'n*, 476 U.S. at 460 (citation omitted). Yet "[s]uch proof is often impossible," as when a restraint has not long existed. *Brown Univ.*, 5 F.3d at 668. Under the indirect method, then, the Government may show that the defendant has the ability to affect industrywide prices, based on such things as its market share, barriers to new entry, or other market characteristics. *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 937 (7th Cir. 2000).

That said, the rule of reason does not create a strict dichotomy between the quick look applicable to obviously anticompetitive restraints and the "plenary market examination" reserved for potentially procompetitive ones. *Cal. Dental Ass'n*, 526 U.S. at 779. "What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint." *Id.* at 781.

2. *Defendant's Burden.* If the Government meets its burden, "the defendant bears the burden of establishing a procompetitive justification." *Id.* at 788 (Breyer, J., concurring in part and dissenting in part). The "defendant may show in the antitrust proceeding that legitimate justifications are present, thereby explaining the presence of the challenged term and showing the lawfulness of that term under the rule of reason." *Actavis*, 133 S. Ct. at 2236. Placing the onus on the defendant to provide an efficiency rationale makes sense—just as it makes sense for Title VII defendants to provide non-discriminatory reasons for employment actions. *Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 142 (2000). As "the author of the restraints," defendants are "in a better position to explain why they are profitable and in consumers' best interests." Phillip Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1505 (Supp. 2017).

An effort to create efficiencies represents the classic procompetitive rationale. Entities may cooperate to produce or distribute their products at a lower cost or higher quality. By buying in bulk, for example, a retailer cooperative may generate "economies of scale" that retailers could not achieve alone, thereby reducing resale prices. *Nw. Wholesale Stationers*, 472 U.S. at 295. Or a merger between beef-packing

firms might create "multiplant efficiencies" in production, allowing them to lower prices by lowering marginal costs. *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 115 (1986). Or copyright owners might agree on a blanket license that allows purchasers to use their collective works in order to reduce the transaction costs associated with thousands of individual licenses. *Broad. Music*, 441 U.S. at 21.

But other allegedly procompetitive rationales are no such thing. Firms, for example, cannot justify a restraint based on "the threat of loss of profits" that competition creates. *Cargill*, 479 U.S. at 117. Ever since then-Judge Taft's decision in *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), courts have rejected such cries of "ruinous competition." *Id.* at 283. Section 1 is not "designed to save inefficient" businesses "from their inability to compete" with efficient ones; it protects "'*competition*, not *competitors*.'" *Leegin*, 551 U.S. at 906 (citation omitted). So a corporation may not "insulate" its product "from the full spectrum of competition because of [an] assumption that the product itself is insufficiently attractive to consumers." *NCAA*, 468 U.S. at 117.

Competitors also cannot foreclose competition in one area because they believe it should occur elsewhere. *See United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972). For example, they cannot justify a horizontal agreement limiting *price* competition on the ground that this limitation channels their competition into product *quality*. *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 693-95. "This is not the kind of procompetitive virtue contemplated under the Act, but rather [a] mere consequence of limiting price competition." *Brown Univ.*, 5 F.3d at 675.

II. THE GOVERNMENT MET ITS BURDEN BY PROVING THAT THE ANTI-STEERING PROVISIONS RESTRAIN COMPETITION AND HARM CONSUMERS

The Government met its burden to prove that Amex's anti-steering provisions are anticompetitive because the provisions raised *industrywide* credit-card prices for merchants above levels that would exist if the networks competed over those prices. That proof sufficed to trigger Amex's burden to offer an efficiency reason for the provisions.

A. Amex's Restraints, Unlike Vertical Restraints In Other Cases, Implicate Section 1's Primary Purpose

As in any rule-of-reason case, the Court should begin with the specific "'circumstances.'" *Actavis*, 133 S. Ct. at 2238 (citation omitted). Two circumstances—one about the specific restraint, the other about the specific market—show that Amex's anti-steering provisions fall within Section 1's core.

1. *Specific Restraint.* Amex's anti-steering provisions bar its merchant customers from encouraging its cardholder customers to use an *Amex competitor's* cheaper card—such as by offering price discounts or non-price perks. Pet. App. 100a-01a. These provisions qualify as vertical restraints because entities at different market levels (Amex and merchants) entered into the agreements in which they are located. *Id.* at 29a-30a, 105a-07a.

These vertical restraints, however, fundamentally differ from vertical restraints that the Court has confronted governing the way in which a manufacturer distributes its goods. The agreements between a

manufacturer and its retailers to set minimum resale prices (in *Leegin*) or to divide retail territories (in *GTE Sylvania*) restricted only intrabrand competition for the manufacturer's product. *Leegin*, 551 U.S. at 890; *GTE Sylvania*, 433 U.S. at 51-52. And those restraints existed to *increase* interbrand competition between the manufacturer's product and competing ones. *Leegin*, 551 U.S. at 890. In this case, by contrast, Amex's anti-steering provisions exist to *decrease* that interbrand competition. They "prevent direct competition between the networks from occurring at the point of sale." Alan Frankel & Allan Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627, 672 (2006). While *vertical* in nature, therefore, these anti-steering provisions have *horizontal* effects in that they reduce interbrand competition among competitors selling different brands—Amex, Visa, MasterCard, and Discover.

This distinction matters. Unlike the restraints in *Leegin* or *GTE Sylvania*, Amex's provisions trigger the "primary purpose of the antitrust laws": to protect *interbrand* competition. *Khan*, 522 U.S. at 15. In fact, the Court's cases instruct the judiciary to "distinguish among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand benefit." *See GTE Sylvania*, 433 U.S. at 52 (criticizing earlier case for failing to do so). *Leegin* even recognized that resale price maintenance *might* harm consumers if it has a horizontal effect by facilitating cartels that reduce interbrand competition. 551 U.S. at 892-93. Here, too, Amex's provisions have the potential for interbrand harm.

2. *Specific Market.* Setting aside the disagreement over whether each side of the credit-card plat-

form counts as a separate "market," no dispute now exists that credit cards themselves make up a distinct market from alternative payment methods (such as cash or debit). Pet. App. 5a n.1, 122a. That fact has significance too.

With only four competitors, this "market remains highly concentrated." *Id.* at 153a. In fact, it is "'well above'" a common index's "'threshold for being highly concentrated.'" *Id.* (quoting Tr. 3941 (Katz)). In addition, it has "high barriers to entry." *Id.* New entry would entail "sizable setup costs." *Id.* at 154a. And, under the "'chicken and the egg problem,'" a new credit-card network "would struggle to convince merchants to join [the] network without a significant population of cardholders and, in turn, would also struggle to convince cardholders to carry a card associated with [the] network that is accepted at few merchants." *Id.* That no network has emerged since 1985 illustrates these entry barriers. *Id.*; Tr. 820-23 (Hochschild/Discover). Before this suit, moreover, *all* four networks used similar anti-steering provisions. Pet. App. 66a-67a, 227a.

Thus, vertical restraints limiting interbrand competition have blanketed a concentrated market with high entry barriers. Even for vertical restraints limiting *intrabrand* competition, the anticompetitive potential increases if all producers in a "highly concentrated industry" pursue a high-price, high-service strategy. It eliminates a consumer's ability to choose the low-price option. F.M. Scherer, *The Economics of Vertical Restraints*, 52 Antitrust L.J. 687, 704 (1983); Easterbrook, *supra*, at 162 (noting that "every one of the potentially-anticompetitive outcomes of vertical arrangements depends on the uniformity of the prac-

tice"). Consumers cannot "choose among low-price, low-service" products and "high-price, high-service" ones if the former do not exist in the market. *Leegin*, 551 U.S. at 890.

In sum, while Amex's anti-steering provisions are vertical in nature, they have horizontal effects on *interbrand* competition and exist within a *concentrated* industry. The Court thus should subject them "to more careful scrutiny" than would apply to a lone producer's vertical restraint restricting *intrabrand* competition in a *competitive* market. *Id.* at 897.

B. By Limiting *Interbrand* Competition, The Anti-Steering Provisions Raise Prices Above Competitive Levels

No matter what standard of proof applies, the Government's "direct evidence of anticompetitive effects" satisfied its burden to show that Amex's anti-steering provisions harm consumers. *Toys "R" Us*, 221 F.3d at 937. Economic theory, the history of Amex's anti-steering provisions, and the provisions' stark real-world effects all prove that the provisions raise the prices that the *entire industry* charges merchants to a higher level than would exist if the networks competed over those prices.

1. *Economic Theory.* Amex's anti-steering provisions have the "'potential for genuine adverse effects'" on price competition. *Actavis*, 133 S. Ct. at 2234 (citation omitted). By prohibiting competition "at the point of sale" among Amex, Visa, MasterCard, and Discover, Frankel & Shampine, *supra*, at 672, these provisions "disrupt the proper functioning of the price-setting mechanism of the market," *Ind. Fed'n*, 476 U.S. at 461-62.

Anti-steering provisions generate this inefficiency because of the credit card network's two-sided nature. Pet. App. 195a. In a normal market, "one would expect to see changes in price result in higher or lower demand for or output of the product or service being sold, depending on the nature of the price change." *Id.* In a credit-card market where merchants cannot steer cardholders to low-cost cards, things do not work this way. A network's price decrease will *not* generate higher demand (and output) for the price-cutting network. *Id.* at 195a-97a.

Merchant demand for a cost-cutting network will be unresponsive to lower prices because, short of not accepting a network's card for *all* transactions, merchants do not make the decision about which card to use for any *particular* one. Cardholders do. Yet cardholders do not internalize the costs that they impose on merchants when doing so, and the anti-steering provisions deprive them of "information" useful for deciding whether a card is "cost justified" for the transaction. *Ind. Fed'n*, 476 U.S. at 461; *cf.* F. A. Hayek, *The Use of Knowledge in Society*, 35 Am. Econ. Rev. 519, 526 (1945). Indeed, Amex's provisions bar merchants even from having notices telling customers about the costs of cards. Pet. App. 101a. Merchants thus lack the ability to respond to a network's lower prices by shifting volume. J.A. 215. And no rational network will cut merchant prices because price cuts will not increase output; they will merely reduce revenue. *Id.*; Pet. App. 195a-97a. These dynamics will cause higher merchant prices across the *industry*. J.A. 224.

This should be unsurprising. "To restrain truthful advertising about lower prices"—as the anti-

steering provisions effectively do—"is likely to restrict competition in respect to price." *Cal. Dental Ass'n*, 526 U.S. 784-85 (Breyer, J., concurring in part and dissenting in part).

2. *History Of Restraints.* The "history" of Amex's modern anti-steering provisions proves the pricing effects that economic principles would predict. *Khan*, 522 U.S. at 10. In the early 1990s, Visa sought to challenge Amex's growing share. At this time, Visa believed, Amex's 3.25% merchant rate was significantly larger than Visa's 1.75% rate. J.A. 206. "Visa sought to call merchants' attention to what it viewed as a 'key Amex vulnerability': namely, [Amex's] higher merchant discount rates." Pet. App. 199a (citation omitted). Its "profit improvement calculator" sharply illustrated the savings that merchants could achieve merely by shifting Amex volume onto Visa. J.A. 101, 207-09. Visa also began a "We Prefer Visa" campaign identifying the higher prices and encouraging merchants to steer volume to its cheaper network. Pet. App. 199a-200a; J.A. 210-11.

These price advertisements had a concrete effect. Merchants shifted volume to Visa by steering cardholders away from expensive Amex cards. Pet. App. 199a-200a; Tr. 4487 (Chenault/Amex). This "share shift away from [Amex] to Visa" sometimes reached "the double digits." Tr. 3843 (Katz). An initiative in Vail, Colorado, even "'showed a 25 to 45 percent shift.'" Tr. 3324-25 (Morgan/Visa) (citation omitted).

This competition put *downward* pricing pressure on Amex, which considered lowering its merchant prices in response. Tr. 4501 (Chenault/Amex). Instead, Amex strengthened its anti-steering provi-

sions and enforced them more vigorously. Pet. App. 200a. It told merchants to "live up to your contract," added contract terms prohibiting preference campaigns, and effectively put an end to those price advertisements. Tr. 4490-93 (Chenault/Amex); J.A. 199. Since then, Amex has required merchants (like Travelocity) not to list competitors (like MasterCard) as preferred cards. Pet. App. 202a. And it has terminated merchants for disregarding the anti-steering provisions. Tr. 3332-34 (Morgan/Visa). These restrictions on price competition achieved their intended result by stopping the shift toward cheaper cards that occurred with merchant steering. Pet. App. 199a-202a. Amex's modern anti-steering provisions thus spring from a campaign to restrict credit-card price competition, not an effort to achieve efficiencies in the distribution of Amex's products. *Id.*

3. *Real-World Effects.* The district court found—as a fact—that Amex's provisions led "all four networks to raise their swipe fees more easily and more profitably than would have been possible were merchants permitted to influence their customers' payment decisions." *Id.* at 207a. The provisions also "render[ed] low-price business models untenable," thereby "resulting in higher prices for merchants and their consumers." *Id.* at 192a.

The evidence confirms these findings. The anti-steering provisions restrain the *entire* industry—not just *Amex*—from competing over merchant prices. An Amex executive conceded that "I don't think anybody's business strategy is to be cheaper than the next guy" and that Amex does not "compete on costs." Tr. 2668 (Funda/Amex). Discover's president, too, recognized that "giving the retailers a discount with-

out getting anything in return didn't make business sense," and that a low-price option is not "viable without the ability to shift share from competitors to Discover at the point of sale." Tr. 853-54 (Hochschild/Discover). Merchants see this lack of price competition. Pet. App. 198a. A Southwest Airlines executive called the market "broken" because networks do not compete for business on the "basis of price." Tr. 2440 (Priebe/Southwest). And a Home Depot executive noted that "every year [the cost of accepting credit cards] continues to go up," but that "[t]here is very little that [they] can do" to prevent the increases. Tr. 1222-23 (Kimmet/Home Depot).

The pricing practices of all four networks show the lack of competition over merchant prices.

Amex. Between 2005 and 2010, Amex engaged in many "Value Recapture" initiatives—Amex's phrase for price increases. Pet. App. 166a. These initiatives sought to maintain Amex's traditional price premium over Visa and MasterCard, whose own price increases had been reducing that gap. *Id.* at 175a; Tr. 2667 (Funda/Amex). The initiatives allowed Amex to raise prices on "merchants accounting for 65% of the network's annual U.S. charge volume." Pet. App. 208a. For several merchants, Amex raised prices more than once. *Id.* at 167a-70a. It raised prices on airlines, for example, by "between 7% and 15%." *Id.* at 167a. In total, the initiatives generated "$1.3 billion in incremental pre-tax income." *Id.* at 170a.

Amex's anti-steering provisions facilitated these increases. *Id.* at 208a. Amex's own analysis about whether it could raise prices did not even consider the possibility that large merchants would steer cus-

tomers away from Amex as a result. *Id.* Instead, the analysis considered only how far Amex could raise prices without large merchants "ceas[ing] acceptance altogether." *Id.* These merchants, unable to steer to low-cost cards, lacked "an important safety valve that would have moderated" the increases. *Id.* Many merchants reiterated that the anti-steering provisions limit their "leverage" to keep prices in check. Tr. 2418 (Priebe/Southwest); Tr. 1258 (Kimmet/Home Depot); Tr. 3219-20 (Gibson/Sinclair Oil); Tr. 580-81 (Bouchard/Sears).

Visa/MasterCard. Anti-steering provisions also enabled Visa and MasterCard to raise their merchant prices "without fear of other networks undercutting their prices in order to gain share." Pet. App. 210a. Both networks increased their all-in merchant rates by over 20% over twelve years. *Id.* Despite Amex's corresponding price hikes, Visa and MasterCard's increases have cut sharply into its traditional price premium. Tr. 2667 (Funda/Amex). The increases, which Visa and MasterCard imposed with "virtual impunity," further "suggest[] an absence of inter-network competition on the basis of price attributable to rules prohibiting merchant steering." Pet. App. 180a. Something is wrong with a market in which the main competitors vigorously compete over who can charge the *higher* prices.

Discover. Discover has also increased merchant prices, but only after its effort to become the low-price option foundered in the face of the anti-steering provisions. Pet. App. 203a-07a. Its failed efforts to raise output by lowering price—the most procompetitive of actions—reinforce economic theory.

In the late 1990s, "Visa and MasterCard were rapidly increasing their prices to merchant[s]." Tr. 833 (Hochschild/Discover). Discover sensed an opportunity to increase its market share by lowering its price. Pet. App. 204a. It encouraged merchants to save money by steering customers to Discover's low-cost network. *Id.* at 204a-05a; Tr. 833-48 (Hochschild/Discover). The campaign did not get off the ground, however, because anti-steering provisions prohibited merchant steering. Pet. App. 205a; Tr. 848-49 (Hochschild/Discover). So Discover abandoned its low-price strategy. With merchants unable to "shift share" to Discover, that strategy meant "giving away money in the form of a lower [price] without getting any benefit in return." Tr. 849 (Hochschild/Discover).

In the campaign's wake, Discover began raising prices "to more closely align its merchant pricing with that of Visa and MasterCard." Pet. App. 206a; Tr. 854 (Hochschild/Discover). Between 2000 and 2007, it raised prices by about 24%. Pet. App. 206a. If, however, "merchants could steer transactions to Discover," it "would aggressively pursue a strategy of lowering [its] prices and providing incentives to merchants that would steer incremental volume to Discover." Tr. 872 (Hochschild/Discover).

These real-world pricing effects for the *entire industry* met the Government's burden to show that Amex's provisions harm consumers. The burden then shifted to Amex to provide a procompetitive reason for them. *Actavis*, 133 S. Ct. at 2236.

III. The Second Circuit Wrongly Required The Government To Prove That The Higher Prices Were Not "Offset" By Higher Rewards, But It Did So In Any Event

To reach a contrary result, the Second Circuit did not dispute the *fact-findings* that Amex's anti-steering provisions restricted interbrand price competition and raised the prices that the credit-card networks charge merchants. Instead, it held that the district court *legally erred* by "elevat[ing] the interests of merchants above those of cardholders." Pet. App. 49a. According to the court, the Government needed to show that these price increases "made *all* Amex consumers on both sides of the platform—*i.e.*, both merchants and cardholders—worse off overall." *Id.* at 51a. Because no "reliable evidence" accounted for how the merchant price increases affected cardholder rewards, the court held, the Government did not meet this initial burden. *Id.* at 54a.

The Second Circuit erred. *First*, it mistakenly required the Government to prove that higher merchant prices were not "offset" by higher Amex cardholder benefits. *Second*, it ignored the fact-findings showing that the Government met this burden.

A. Section 1 Presumes That Higher Prices Caused By Restraining *Interbrand* Price Competition Inflict Net Consumer Harms

The Second Circuit wrongly required the Government to prove that the higher merchant prices caused by Amex's restrictions on interbrand price competition were not counterbalanced by higher cardholder rewards. Even *assuming* that the entire credit-card platform counts as the "relevant market,"

this conclusion conflicts with cases holding that competition sets a product's "optimal" attributes; economic theory illustrating that price restraints harm consumers; and traditional administrative concerns. And these factors all confirm that the Second Circuit should not have departed from this Court's usual market-definition test by defining the "relevant market" to include cardholders and merchants.

1. The Second Circuit's analysis conflicts with the Sherman Act's guiding light that competition generates "optimal" products

The Second Circuit held that Amex could limit price competition with Visa, MasterCard, and Discover to obtain its "optimal" rewards level. Pet. App. 50a. Amex's anti-steering provisions, the court reasoned, "protect[]" the "revenue" that funds these rewards from price cuts by competitors. *Id.* That reasoning represents "nothing less than a frontal assault on the basic policy of the Sherman Act." *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 695. Section 1 rests on the "legislative judgment" that competition among different suppliers—not decisions by public or private central planners—generates the *optimal* level of a product's price and non-price characteristics. *Id.*

Indeed, this Court has repeatedly refused to uphold attempts to limit interbrand competition on the ground that those restrictions merely "channeled" competition into "proper" areas. It has said that competition "cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy." *Topco*, 405 U.S. at 610. Within a

sector, moreover, "[t]he assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers"—i.e., by competition governing each of those elements. *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 695.

Many cases illustrate this point. In *National Society of Professional Engineers*, engineers entered into a horizontal agreement not to engage in price bidding. 435 U.S. at 693-94. They defended that *price* restraint on the ground that it increased competition over *quality*, "preventing the production of inferior work." *Id.* The Court rejected this defense, noting that it had "never accepted such an argument." *Id.* at 694. When doing so, the Court did not require the Government to prove that the higher prices did not outweigh the higher quality. *Id.* at 693-96. Instead, it explained that the "Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services." *Id.* at 695. So "the statutory policy precludes inquiry into the question whether competition is good or bad." *Id.*

The Court made the same point in *Indiana Federation of Dentists*, which involved a three-way relationship between dentists, insurers, and patients. The *dentists* entered into a horizontal agreement not to provide x-rays to *insurers*, which had requested them to decide whether proposed treatments were cost justified. 476 U.S. at 459, 461. The dentists argued that the reduction in price competition (and higher *insurer* costs) would increase the quality of

care for *patients*. *Id.* at 462-63. The Court rejected this defense that "an unrestrained market in which consumers are given access to the information they believe to be relevant to their choices will lead them to make unwise and even dangerous choices." *Id.* at 463. Competition sets the optimal level of price and quality characteristics in dental care, too. *Id.* The Court nowhere required the Government to prove that the asserted higher quality did not offset the higher prices. *Id.*; *Brown Univ.*, 5 F.3d at 675 (rejecting argument that, "by eliminating price competition among participating schools," a restraint "channelled competition into areas such as curriculum, campus activities, and student-faculty interaction").

Invoking similar reasoning, *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980), held that the *per se* rule applied to a horizontal agreement among beer wholesalers not to extend free credit to retailers. *Id.* at 650. A lower court had rejected the *per se* rule because the restriction on competition with respect to credit could "sharpen competition with respect to price." *Catalano, Inc. v. Target Sales, Inc.*, 605 F.3d 1097, 1099 (9th Cir. 1979). This Court refused to depart from the *per se* rule on that ground. 446 U.S. at 646-50. It conceded that a restriction on competition over credit may "lead in a competitive market to corresponding decreases in the invoice price." *Id.* at 649. But that fact did not rebut the *per se* rule or require a plaintiff to prove an inadequate offset—i.e., that the credit reduction was not offset by a commensurate price reduction. *Id.*

The same logic informs the rule of reason here. The Second Circuit nowhere disputed that Amex's anti-steering provisions restrict *interbrand* competi-

tion with Visa, MasterCard, and Discover over merchant prices. Instead, it justified those provisions on the ground that they protect the "important revenue" that funds Amex's rewards from ruinous price competition. Pet. App. 50a; *cf. Addyston Pipe*, 85 F. at 283. But "*competition* should choose the optimal mix" of merchant prices and cardholder rewards, just as it chooses the optimal mix of a product's price and quality attributes. Areeda & Hovenkamp, *supra*, ¶ 562e (Supp. 2017). "[T]he Rule of Reason does not support" the Second Circuit's view that this price competition is "unreasonable." *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 696. And Amex cannot justify its interbrand price restraints based on the "threat of loss of profits" that price competition would create. *Cargill*, 479 U.S. at 117. Nor can it "insulate" its high-price, high-reward product "from the full spectrum of competition because of [an] assumption that the product itself" would be unattractive to consumers if they actually had the option to choose low-price alternatives. *NCAA*, 468 U.S. at 117.

To be sure, cases like *National Society of Professional Engineers* and *Indiana Federation of Dentists* involved *horizontal* agreements among competitors to restrict interbrand price competition, whereas this case involves *vertical* agreements between Amex and its merchant customers. But that difference does not matter for reasons explained above. Unlike other vertical agreements, Amex's agreements have the horizontal effect of restricting interbrand price competition between all competitors, and so trigger "the primary purpose of the antitrust laws." *Khan*, 522 U.S. at 15. As with a horizontal restraint, Amex's anti-steering provisions "impose[] [its] views of the

costs and benefits of competition [over merchant prices] on the entire marketplace." *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 695.

The Second Circuit relegated this distinction between *interbrand* and *intraband* competition to a footnote. Pet. App. 30a n.42. Yet it is not just a "meaningful difference"; it is a critical one. *Id.* If Amex's restraints effectively raised only *its* prices (to account for *its* rewards), they would be analogous to resale price maintenance. Interbrand competition would act as a check on Amex's higher prices because low-price competitors could undercut Amex's share if its rewards did not add sufficient value to offset its higher prices. *Leegin*, 551 U.S. at 896. But *no* such check exists here given the restraints' interbrand effect. Discover's failed attempt to offer a low-cost option vividly illustrates this fact. Pet. App. 204a-07a.

In sum, the Second Circuit adopted an argument—that competition over merchant prices is "bad"—that this Court has "never accepted." *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 694-95. This case should not be the first one in which it does so.

2. The Second Circuit's analysis conflicts with economic principles illustrating that interbrand price restrictions harm consumers even if competition occurs elsewhere

Section 1's goal—consumer welfare—justifies the Court's refusal to uphold attempts to restrict interbrand price competition in order to channel competition elsewhere. Such restrictions create a misallocation of resources, not allocatively efficient markets.

Price cartels prove this point. The cartel's *price* restriction will lead members to increase *non-price* competition over service or quality. Posner, *Antitrust Law*, *supra*, at 14; *see generally* George Stigler, *Price and Non-Price Competition*, 76 J. Pol. Econ. 149 (1968); Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies and Theft*, 5 W. Econ. J. 224 (1967). "Each member of the cartel will have an incentive, by expending resources on making his output more valuable to consumers than the output of the other members of the cartel, to increase his sales relative to the other cartelists and thereby engross a larger share of the cartel profits." Posner, *Antitrust Law*, *supra*, at 14. But courts have never held that this consumer benefit justifies a departure from the *per se* rule. *See Leegin*, 551 U.S. at 893. Nor has this benefit led to a mandate to prove that a cartel's price increases were not "offset" by service increases. *Cf. Brown Univ.*, 5 F.3d at 675.

That is because this consumer benefit will only *partially* offset the higher prices. "The reason it is only partially offsetting is that if consumers valued the additional services generated by this competition above its cost, presumably the services would have been produced in a *price-competitive market* as well." Posner, *Antitrust Law*, *supra*, at 14 (emphasis added). The cartel creates a "misallocation of resources" in which consumers receive marginal benefits that they do not value at their marginal costs. Richard Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 Univ. Chi. L. Rev. 6, 20 (1981).

The price-controlled airline industry provides a concrete example of this effect. The Civil Aero-

nautics Board set prices too high, which "in turn stimulated service competition" by the airlines. Scherer, *supra*, at 703. But this price setting generated more services than consumers would choose in price-competitive markets. *Id.* at 703-04 (citing George Douglas & James Miller, *Quality Competition, Industry Equilibrium, and Efficiency in the Price-Constrained Airline Market*, 64 Am. Econ. Rev. 657 (1974)). Most travelers, for example, likely did not view "the piano bars that American Airlines installed in its Boeing 747 airliners" as worth their costs. Richard Posner, *Economic Analysis of Law* 385 (7th ed. 2007). After all, airlines now drill holes in beverage-cart drawers to reduce weight (and fuel costs). Tr. 222 (Thiel/Alaska Airlines).

Similar principles are at work here. Amex's anti-steering provisions—by limiting the industry's competition for merchant prices—permit competition in unrestricted areas. Card issuers thus compete over cardholder rewards. But, as with a cartel, the rewards do not offset the higher prices. Tr. 3854 (Katz); Frankel & Shampine, *supra*, at 634 & n.25. If they did, the rewards would be provided in a competitively priced market (and Amex would not need its restraints). Posner, *Antitrust Law*, *supra*, at 14. Instead, those restraints misallocate resources because consumers buy rewards that they do not value at their costs. In this respect, Amex's argument that it needs price restraints to provide its rewards is like an airline claiming that it needs price restraints to provide its piano bars.

If anything, the two-sided nature of the credit-card platform increases the inefficiencies. Amex cardholders do *not* pay the full costs of their rewards.

Instead, merchants pass on higher credit-card costs to *all* consumers in the form of higher retail prices. Pet. App. 210a-11a; Tr. 3855 (Katz). Thus, Amex's "customers do not internalize the full cost of their payment choice" and impose costs on *other* consumers. Pet. App. 195a, 211a. This negative externality causes consumers to overuse high-cost cards because the cardholders receive *all of the cards' benefits* but shift *some of their costs* to others. Because the anti-steering provisions "distort competitive markets by steering consumers toward using more costly and less efficient payment methods," Frankel & Shampine, *supra*, at 672, the Second Circuit was wrong to rely on increased credit-card usage as a basis for upholding those provisions, Pet. App. 52a.

This negative externality also illustrates that Amex's reliance on this Court's vertical-restraint cases flips them on their head. The restraints in those cases sought to eliminate a free-rider problem in which no-frills retailers enjoyed *some of the benefits* of the provision of retail services, but the service-providing retailers bore *all of their costs*. *Leegin*, 551 U.S. at 890-91. The restraints in this case, by contrast, seek to exacerbate a free-rider problem by increasing cross-subsidies among consumers. Allocative efficiency and consumer welfare are not enhanced if Discover cardholders pay higher prices at the gas station to subsidize an Amex cardholder's frequent-flyer miles.

Even Amex's *own* cardholders are worse off. Without the anti-steering provisions, merchants could offer Amex cardholders incentives to use different cards. "[I]f a merchant wants to say to [an Amex cardholder], I'll give you a one percent discount if you

use Discover," the cardholder would get to *choose* between the cheaper transaction (with Discover) and the more expensive one (with Amex plus rewards). Tr. 4621 (Chenault/Amex). This choice would help all cardholders internalize the costs of their cards, giving them greater choice in the process. Additionally, for every Amex customer who would choose the merchant's cheaper offer, the costs of their high-cost cards do not exceed their benefits. Yet that choice is "absolutely" precluded by Amex's provisions. *Id.* As this Court has said elsewhere, Amex is not "justified in deciding on behalf of its . . . customers that they [do] not need [this choice]." *Ind. Fed'n*, 476 U.S. at 462. And it "is not entitled to pre-empt the working of the market by deciding for itself" what is in its cardholder consumers' best interests. *Id.*

3. The Second Circuit's analysis conflicts with this Court's administrative concerns

In addition to Section 1's consumer-welfare ends, this Court's previous reliance on administrative factors weighs against the Second Circuit's "offset" test. *Pac. Bell*, 555 U.S. at 452-55. The lower court's test imposes judicial costs that this Court has rejected in other areas, and the test gives a potential pass to large amounts of anticompetitive conduct.

Start with the judicial costs. This Court has been reluctant to adopt legal rules that—by "seek[ing] to embody every economic" principle, *Barry Wright*, 724 F.2d at 234—impose "evidentiary complexities and uncertainties," *Ill. Brick*, 431 U.S. at 731-32. The Court has held, for example, that a price-fixer could not assert that plaintiff retailers passed along the price-fixer's higher prices to customers because of the

alleged difficulties in measuring the pass-on amounts. *Hanover Shoe*, 392 U.S. at 491-94. And it has rejected a price-squeeze claim—that a vertically integrated monopolist set wholesale prices to its competitors at high levels and retail prices to consumers at low levels—because it would be difficult to police the "*interaction*" between "wholesale and retail prices." *Pac. Bell*, 555 U.S. at 453.

The Second Circuit's test raises similar concerns because it requires a calculation of *two* prices. Whether Amex's anti-steering provisions help or harm cardholders would require courts to consider two pass-on amounts. On the one hand, as noted, *merchants* will pass on a portion of the higher credit-card costs to *all* of their consumers in the form of higher retail prices. Pet. App. 210a-11a. On the other, *Amex* may pass on some of its revenue from higher prices to *its* customers in the form of rewards. Frankel & Shampine, *supra*, at 634 & n.25. Examining "the *interaction* between these two" pass-on amounts could prove "difficult." *Pac. Bell*, 555 U.S. at 453. The "evidentiary complexities and uncertainties involved" would add "costs to the judicial system" that this Court has found inappropriate in other cases. *Ill. Brick*, 431 U.S. at 732.

At the least, *Amex* should bear the burden to prove that any indirect cardholder gains outweigh direct merchant losses. After all, "the burden of proof should be assigned to the party with the less plausible claim." Hovenkamp, *supra*, at 309. In that respect, this case reverses the presumptions that drove this Court's demanding test for predatory-pricing claims. The Court called mistaken liability rulings in that context "'especially costly'" because

they chilled procompetitive conduct—reducing prices to increase market share. *Brooke Grp.*, 509 U.S. at 226 (citation omitted). Here, by contrast, the anti-steering provisions are not "moving prices in the 'right' direction." *Barry Wright*, 724 F.2d at 231. They are moving prices in the "wrong" direction, as Discover's failed low-price option proves.

In addition, predatory-pricing claims rest on speculation that a price-cutting producer might seek *anticompetitive* monopoly profits later. *Brooke Grp.*, 509 U.S. at 224-26. Here, however, it is the restraint's allegedly *procompetitive* benefits that arise later—as issuers disburse revenues from the higher prices to certain cardholders. If speculative consumer harms did not warrant prohibiting concrete consumer gains in that context, speculative consumer gains should not warrant licensing concrete consumer harms in this one. The costs of false positives are high there, just as the costs of false negatives are high here, for the same reason: "'Low prices benefit consumers regardless of how those prices are set.'" *Id.* at 223, 226 (citation omitted).

4. The Second Circuit's need to create a novel market-definition test confirms its error

For these reasons, the Second Circuit wrongly required the Government to prove that the higher merchant prices caused by Amex's anti-steering provisions were not counterbalanced by more cardholder benefits—*even assuming* both are in one market. Yet the court never should have sailed into this sea of doubt because the usual market-definition test avoids the complexities. The Second Circuit fell into them by defining the "market" broadly to include

both sides of the credit-card platform. Pet. App. 31a-40a. Its analysis conflicts with this Court's *general* test to identify the relevant market, and its *specific* use of that test for multi-sided platforms.

As a *general* matter, the Second Circuit's approach departs from the test that the Court has long applied to identify whether a different product falls within the "relevant market" of the product that is at issue in the antitrust case. To decide that question, the Court has asked whether the different product is "reasonably interchangeable" with the at-issue product. *See United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966); *Int'l Boxing Club of N.Y., Inc. v. United States*, 358 U.S. 242, 250-51 (1959). In *NCAA*, for example, the Court concluded that the NCAA violated Section 1 by restricting the number of college football games that broadcasters could air on television. 468 U.S. at 99-120. In the process, it upheld a finding that "college football broadcasts" were a relevant market separate from other television shows because those other broadcasts were not "reasonably substitutable for televised NCAA football games." *Id.* at 111.

Here, the credit-card industry's services to *cardholders* do not meet this test because they are not "reasonably interchangeable" with the industry's different services to *merchants*. *Grinnell*, 384 U.S. at 571. If the credit-card industry raised prices on merchants, those merchants could not simply switch from the merchant services that they purchase to the cardholder services that cardholders obtain from issuers. While interrelated, the services offered to customers on one side of this platform are fundamentally different "products" from the services offered on

the other. The two services are complements, not substitutes. Areeda & Hovenkamp, *supra*, ¶ 565 (Supp. 2017).

Rather than apply the established market-definition test, the Second Circuit created a new one. Because prices in the market for merchant services *affect* prices in the market for cardholder services, the Second Circuit held that both markets should be consolidated into one for antitrust purposes. Pet. App. 39a-40a. Yet pricing in one market often affects pricing in another, but that interdependency does not collapse the two markets into one. If it did, "there [could] never be separate markets, for example, for cameras and film, computers and software, or automobiles and tires." *Eastman Kodak Co. v. Image Tech. Servs.*, 504 U.S. 451, 463 (1992). This case proves the point in that merchants pass on higher credit-card prices to consumers in the form of higher retail prices. Pet. App. 210a-11a. But that does not mean that the market for credit-card services should be lumped together with the market for retail goods.

The Second Circuit's market definition makes even less sense when considered from Visa or MasterCard's perspectives. Unlike Amex and Discover, they have not vertically integrated into the issuing market. In that market, Amex and Discover compete with *thousands* of banks that issue Visa and MasterCard cards. Pet. App. 81a-84a, 117a; *Visa*, 344 F.3d at 237. That this issuing market includes a separate volume metric—the amount of loans outstanding—illustrates its distinct nature. Tr. 815-17 (Hochschild/Discover). Simply because Amex, by virtue of its business model, provides different services to different customers does not mean that all of those

services should be put into the same market. Visa and MasterCard's disaggregated models show that these services *can* be provided separately, and thus that the markets should be treated as separate ones. *Kodak*, 504 U.S. at 463.

As a *specific* matter, the Second Circuit's decision departs from this Court's cases concerning multi-sided platforms. Those platforms are not new. Newspapers, which bring together readers and advertisers, predate the Sherman Act. Notably, the Court has treated the readership market as separate from the advertising market. *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 610 (1953). In *Times-Picayune*, a corporation required advertisers seeking to advertise in its "Times-Picayune" newspaper (the only morning paper in New Orleans) to advertise additionally in its "States" newspaper (an evening paper competing with another evening paper, the "Item"). *Id.* at 597-600. The United States asserted that the corporation had adopted an unlawful tying scheme by requiring those who wanted to advertise in the dominant Times-Picayune to advertise in the evening States. The district court ruled for the United States. *Id.* at 600-01.

This Court disagreed. It recognized that a newspaper "is a dual trader in separate though interdependent markets." *Id.* at 610. A newspaper "sells the paper's news and advertising content to its *readers*," and "that readership is in turn sold to the *buyers of advertising space*." *Id.* (emphases added). The case, however, "concern[ed] solely one of these markets." *Id.* The corporation did not require *readers* to purchase the States and the Times-Picayune; it required *advertisers* to do so. *Id.* The Court thus re-

versed initially because the Times-Picayune did not have a dominant position in the New Orleans *advertising* market. *Id.* at 611-12. It then held that, while *readers* distinguished between the two papers, *advertisers* would have viewed the papers as the same product—readership. *Id.* at 613. Thus, the Court ruled that the corporation had not tied two products together when assessed from the advertisers' perspective; the products were identical to them. *Id.* at 613-14; *cf. Lorain Journal Co. v. United States*, 342 U.S. 143, 154 (1951). While *Times-Picayune* involved a two-sided platform and the Court treated each side as a "separate" market, 345 U.S. at 610, the Second Circuit did not distinguish (or even cite) that case.

The Second Circuit's decision also conflicts with *NCAA*. That case involved a multi-sided platform with television broadcasters using content (like football games) to unite advertisers and viewers. 468 U.S. at 111. When affirming a market-power finding against one content provider (the NCAA), the Court relied on the *advertisers'* perspective. From their standpoint, the Court reasoned, the *viewers* (not the *football games*) were the product (just as readers were the product in *Times-Picayune*). *Id.* And football fans were a separate market from other viewers because they had unique "demographic characteristics" for which advertisers paid higher prices. *Id.* at 111-12. Only in a footnote did the Court add separately that the *games* had "unique appeal" to *viewers* too. *Id.* at 111 n.49. Under *NCAA*, Amex's restraints should be analyzed from the separate perspectives of merchants and cardholders because cardholders are part of the "product" that networks sell to merchants.

B. The District Court Factually Found That Amex's Restraints Harmed The Cardholder Side Of The Platform Too

Even if the Government were required to prove that higher industrywide merchant prices were not sufficiently "offset" by higher Amex cardholder rewards, the Second Circuit wrongly held that the Government failed to do so. The circuit court simply ignored the district court's contrary fact-findings.

To begin with, the district court found, as a fact, that Amex's restraints inflicted industrywide harm on the *cardholder* side of the credit-card platform. "Merchants facing increased credit card acceptance costs will pass most, if not all, of their additional costs along to their customers in the form of higher retail prices." Pet. App. 210a-11a. Its finding comports with substantial merchant testimony. Retailers in competitive markets must "pass those costs on to [their] customers." Tr. 1406 (Rein/Walgreens). Conversely, merchants will pass along cost *reductions* to their customers in the form of lower prices. Tr. 1278 (Kimmet/Home Depot). The district court's finding also comports with expert testimony: "So what's going to happen is prices are going to go up with the merchant for everybody." Tr. 3855 (Katz).

The Second Circuit all but ignored these higher retail prices. In a footnote, it suggested that the district court's reliance on them was "erroneous, as it fail[ed] to take into account offsetting benefits to cardholders in the form of rewards and other services." Pet. App. 49a n.52. Two problems exist with this footnote. As an initial matter, only some retail consumers (Amex cardholders) receive the offsetting

benefits that all consumers pay for through higher prices. This "externality," which the Second Circuit overlooked, harms many others on the cardholder side of the market. *Id.* at 212a.

Additionally, contrary to the Second Circuit's claim, *id.* at 49a n.52, the district court did "take into account" cardholder rewards. The district court found—again, as a fact—that Amex's higher prices from its Value Recapture initiatives "were not wholly offset by additional rewards expenditures or otherwise passed through to cardholders, and *resulted in a higher net price.*" *Id.* at 209a (emphasis added). Amex itself noted that it drops part of its price premium to its "bottom line" rather than investing it in cardholder benefits. *Id.*; *id.* at 166a-67a. In fact, Amex's "rewards payments [were] well less than half of" its merchant prices. Tr. 3853 (Katz). Even the Second Circuit *conceded* that "not all of Amex's gains from increased merchant fees are passed along to cardholders in the form of rewards." Pet. App. 51a.

In sum, the Government met its burden to show consumer harm because it proved that Amex's anti-steering provisions raised the merchant prices of all four networks by blocking their competition over those prices. And, if the Government needed to prove a higher two-sided price that considered cardholder rewards, it met that burden too.

CONCLUSION

The judgment of the court of appeals should be reversed.

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